



To: The Leader and Executive Councillor for Strategy :
Councillor Tim Bick
Report by: Director of Resources
Relevant scrutiny Strategy & Resources Scrutiny 09/7/2012
committee: Committee
Wards affected: All Wards

ANNUAL TREASURY MANAGEMENT REPORT 2011/12

1. Executive summary

This Council is required through regulations issued under the Local Government Act 2003 to produce an annual treasury report reviewing treasury management activities and the actual prudential and treasury indicators for 2011/12. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code 2011).

2. Recommendations

The Executive Councillor is asked to recommend this report, which includes reporting of the Council's actual Prudential and Treasury Indicators for 2011/12, for approval by Council.

3. Background

This report provides information on:

- Capital expenditure and financing activity during the year;
- The impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- The overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on deposit balances;
- The required prudential and treasury indicators;
- Interest rate movements in the year;
- Borrowing activity relating to the Self-Financing of the Housing Revenue Account (HRA); and

- Detailed deposit activity

3.1 The Council's Capital Expenditure and Financing 2011/12

The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply such resources, the capital expenditure will give rise to a borrowing need.

The actual capital expenditure forms one of the prudential indicators required to be reported. The table below shows the Council's actual capital expenditure and how this was financed.

	2010/11 £000 Actual	2011/12 £000 Revised Estimate (*)	2011/12 £000 Actual
Non-HRA capital expenditure	5,032	15,260	8,194
HRA capital expenditure	9,514	20,669	9,917
HRA Reform	-	-	213,572
Total capital expenditure	14,546	35,929	231,683
Resourced by:			
• Capital receipts	3,296	6,227	4,093
• Other contributions	11,250	29,702	14,018
• Borrowing for HRA Reform	-	-	213,572
Total available resources for financing capital expenditure	14,546	35,929	231,683
Un-financed capital expenditure	-	-	-

(*) Per Medium Term Strategy Agreed on 20 October 2011

3.2 The Council's overall borrowing need

External borrowing for 2011/12 was undertaken for a capital purpose due to HRA Reform amounting to £213.572m. This borrowing was from the Public Works Loans Board (PWLb) and benefited from the availability of preferential loan rates specifically for this Self-Financing

transaction. The loan portfolio consists of 20 maturity loans each for £10,678,600. The first loan will mature on 28 March 2038 and the last on 28 March 2057. A table setting out the PWLB borrowing portfolio is included in the Treasury Management Position Statement as at 31 March 2012 included as Appendix A.

3.3 Treasury Position as at 31 March 2012

The Council's debt and deposit position is organised by the Council's own treasury management staff in order to ensure adequate liquidity for revenue and capital activities, security for deposits and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through Member reporting (as outlined in the summary) and through officer activity detailed in the Council's Treasury Management Practices.

The table below shows comparative deposit outturn for 2011/12 against 2010/11.

Deposit Type	2010/2011			2011/2012		
	Average Deposits	Rate of Return	Benchmark Return	Average Deposits	Rate of Return	Benchmark Return
1. Internally Managed Funds						
Fixed Short-Term (<365 days)	£56.84m	0.55%	0.61%	£63.08m	0.75%	0.94%
Call/Overnight Accounts	£3.82m	0.28%	0.43%	£6.52m	0.38%	0.48%
Fixed Long-Term (>365 days)	-	-	-	-	-	-
2. Externally Managed Funds						
Managed Funds	-	-	0.61%	-	-	0.48%
3. Overall Deposit Return						
	£61.34m	0.60%	-	£69.60m	0.72%	-

Notes:

- The 'Benchmark Return' figures are based upon Sector Treasury Management's average money market 3-month London Interbank Bid

Rate (LIBID), for the Council's Fixed Short-Term deposits and their average money market Overnight Rate, for the Council's Call/Overnight deposits;

- All deposits were under one year.
- The Council's performance against the national benchmark is lower than average. However, this is mainly due to the restrictions that the Council had adopted on the total balances that can be deposited with an individual institution or group. (These totals were increased by Council on 23 February 2012 to enable the authority to receive a better rate of return on its deposits.) In addition, the requirement to determine a suitable borrowing strategy for the HRA led to a decision to restrict the periods for which funds would be deposited to the short term. This action was taken in order to retain flexibility should internal borrowing be utilised. This policy had an impact on the interest rate received on deposits.

3.4 Interest of £494,000 has been earned on the Council's deposits during 2011/12 at an average rate of 0.72%. This return compares favourably with the average 7 day London Interbank Offered Rate (LIBOR) rate of 0.61% as at 30 March 2012. The original budget for interest earned in 2011/12 was £312,000. Interest yield has therefore been over-achieved by £172,000 for the year 2011/12 although this was in part due to higher levels of deposit than originally forecast.

3.5 Appendix A to this report shows the Treasury Management Position Statement as at the end of the financial year.

3.6 Borrowing

On 28 March 2012, the Council undertook borrowing of £213.572m in order to finance the one-off payment to central government in relation to the introduction of a new HRA Self-financing regime with effect from 1 April 2012. The overall borrowing need was detailed in paragraph 3.3 above. This was the only external borrowing undertaken in the year.

3.7 The Economic Background

The Council's Treasury Management advisors, Sector, provide information on the national and world economy. This information is provided below to give context to the current Treasury Management strategy and practices, based on the position at March 2012.

The outlook for the global economy remains clouded with uncertainty. The UK economy has struggled to generate a sustained recovery so this offers little hope for a strong recovery in 2012, and possibly even into 2013. Consumer and business confidence levels are generally low and it is not easy to see potential for a significant increase in the growth rate in the short term.

- The Eurozone Sovereign debt crisis has abated following agreement on a second bailout package of €130bn for Greece in mid February;
- The European Central Bank provided c. €1trn of 3yr funding to EU banks at 1%;
- Eurozone banks used this financing at 1% to buy new sovereign debt issues yielding significantly higher rates; this has pushed some Eurozone sovereign yields down below 'panic' levels – notably Spain and Italy;
- One potential problem on the horizon is various national elections; Germany in 2013; French presidential election result in May 2012, where Sarkozy lost to the Socialist front runner Francois Hollande;
- Major uncertainties surround future prospects for the Eurozone.

US

- Economic prospects have been encouraged by some positive news, but improvement is still limited;
- The likelihood of a weak rate of growth going forward will mean slow progress in reducing the high level of unemployment which is acting as such a dampener on the economy;
- Ben Bernanke (the Chairman of the Federal Reserve) has hinted at the possibility of another round of Quantitative Easing (QE) aimed at encouraging a strong enough rate of growth to reduce the total level of unemployment significantly;
- The US still has to address reducing the huge total of public debt and annual deficits by adopting austerity measures;
- Presidential elections are due in November 2012.

China

- Falling inflation has opened the way for relaxing credit restrictions to boost growth, which has been flagging;
- However, current expectations are that it will maintain a reasonable rate of growth, though less than in previous years.

UK

- Austerity measures, aimed at getting the public sector deficit into order over the next four years, have yet to fully impact on the economy;

- However, it looks likely that the private sector will not make up for the negative impact on employment in the public sector over the next year;
- Lack of significant progress in generating a rebalancing of the UK economy to manufacturing from services and an export led recovery - albeit some upbeat data in April has been received;
- The housing market, a gauge of consumer confidence, remains weak and the outlook is for house prices to be little changed for a prolonged period;
- Economic forecasts for 2012 and beyond have been revised lower on a near quarterly basis;
- Bank of England embarked on a £75bn second round of QE to stimulate economic activity in October 2011. Another £50bn was added to the programme in February 2012. The Bank of England Monetary Policy Committee is currently split on whether there needs to be another increase in QE in 2012, after some reasonably encouraging economic statistics, indicating that the fall in GDP in Q4 2011 looks like being a one off, rather than the start of a new trend towards recession;
- Inflation has eased from its peak of 5.2% (Consumer Price Index [CPI]) in September 2011, with strong expectation that CPI will hit the 2% target rate within the MPC's two year time horizon;
- The UK's AAA rating was put on negative outlook by Moody's in February 2012 and by Fitch in March. Concerns over growth outlook and potential shocks from the Eurozone combine to also depress growth;
- However, "safe haven" status has underpinned demand for gilts and kept yields at historic lows. Unlikely to see material change in near term.

Given the volatile nature of the global economy this information is constantly changing. The above paragraph includes the position reported by Sector in March 2012, reflecting the end point of the period reported on. The Council will be reviewing the latest position as part of the forthcoming Medium Term Strategy, together with any resulting amendments to treasury management practice which are deemed appropriate.

3.8 Sector's forward view

Economic forecasting remains difficult with so many external influences weighing on the UK. Key areas of uncertainty include:

The potential for the unravelling or failure of implementation of the second Greek bailout package causing a worsening of the Eurozone debt crisis. The failure of Greece to form a coalition government in May 2012.

Inter-government agreement on how to deal with the Eurozone debt crisis could fragment, particularly as a result of upcoming national election results;

The impact of the Eurozone crisis on financial markets and the banking sector;

The impact of the UK Government's austerity plan on confidence and growth;

Potential for failure of UK inflation to fall back to near the 2% target;

Monetary policy action failing to stimulate growth in western economies;

- The potential for weak growth or recession in the UK's main trading partners - the EU and US;
- High oil prices depressing world growth and stoking inflation;
- The political situation in the Middle East, particularly over Iran's nuclear ambitions;
- Potential for protectionism i.e. an escalation of the currency war / trade dispute between the US and China;
- A hard landing for slowing growth in China.

Sector believes that the longer run trend is for gilt yields and PWLB rates to rise due to the high volume of gilt issuance in the UK, and the high volume of debt issuance in other major western countries.

Given the weak outlook for economic growth, Sector sees the prospects for any interest rate changes before late 2013 as very limited. There is potential for the start of Bank Rate increases to be even further delayed if growth disappoints.

3.9 Interest rates

Sector provide the following forecast for UK interest rates:

	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
Bank rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.25%	1.50%
5yr PWLB rate	2.00%	2.10%	2.20%	2.20%	2.30%	2.40%	2.50%	2.60%	2.80%	3.00%	3.20%	3.40%
10yr PWLB rate	3.00%	3.00%	3.20%	3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	4.00%	4.20%	4.40%

25yr PWLB rate	4.20%	4.20%	4.30%	4.30%	4.40%	4.50%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%
50yr PWLB rate	4.30%	4.30%	4.40%	4.40%	4.50%	4.60%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%

The Sector central forecast is for the first increase in bank rate to be in March 2014. With low growth predictions for the U.K, and financial markets unconvinced that politicians have resolved the Eurozone sovereign debt crisis, we are likely to continue to experience high levels of volatility.

3.10 Icelandic Bank Deposits

This authority had the following short term deposits in Icelandic banks and their UK subsidiaries at the time of the collapse of Icelandic banking institutions in 2008/09.

Counterparty	Principal	% Rate	Deposit Date
Heritable Bank Limited	1,000,000	5.65000%	09-Jan-08
Heritable Bank Limited	1,000,000	6.21000%	13-Jun-08
Landsbanki Islands hf	2,000,000	6.22000%	30-Jun-08
Heritable Bank Limited	2,000,000	6.00000%	05-Sep-08
Landsbanki Islands hf	1,000,000	6.35000%	01-Jul-08
Landsbanki Islands hf	2,000,000	6.42000%	01-Jul-08
Deposits placed in 2008/09	9,000,000	6.14041%	

The Icelandic Government has stated its intention to honour all its commitments as a result of their banks being placed into receivership. The U.K. Government is working with the Icelandic Government to help bring this about. At the current time, the process of recovering assets is still ongoing with the respective administrators and winding up boards. The Local Government Association is co-ordinating the efforts of all UK authorities with Icelandic deposits.

Based on the latest CIPFA Local Authority Accounting Panel (LAAP) Bulletin 82 (revised 14th May 2012), the Council is anticipating that it will recover between 86% to 90% of its claim against Heritable Bank Ltd and 100% of its claim against Landsbanki Islands hf. Provisions have been made as part of the Council's accounts to reflect this basis.

Heritable Bank Limited

At the end of 2011/12, the total of dividends received from the administrators of Heritable Bank Plc equating to a payment of £2.766m which represented 67.90 pence in the pound of the total claim. In addition £154,328 has been received in the current financial year, bringing the total dividends to date to £2,920,348 (71.69 pence in the pound)

Landsbanki Islands hf

The Landsbanki test case appeal hearings took place in the Supreme Court of Iceland on 14 and 15 September 2011. On 28 October 2011 the Icelandic Supreme Court ruled that the deposits placed by the test case UK local authorities and other wholesale depositors in Landsbanki hf have priority status over other creditors in the winding up of the bank.

On 19 January 2012 the Icelandic Supreme Court approved settlement of the claims placed by the non-test case UK local authorities in Landsbanki hf

At the end of 2011/12, the Council had received one dividend of £1.518m from the winding-up board in respect of Landsbanki Islands hf, equating to approximately one third of the Council's claim. A further distribution was received on 29 May 2012 increasing the percentage recovered to approximately 40%.

3.11 Compliance with Treasury Limits

During the financial year the Council operated within the 'authorised' and 'operational' borrowing limits contained within the approved Prudential Indicators set out in the Council's Treasury Management Strategy Statement. For information, the outturn for the Prudential Indicators are shown in Appendix B.

4. Background papers

These background papers were used in the preparation of this report:

Treasury Management Strategy Statement & Annual Deposit Strategy – Budget Setting Report to Council 23rd February 2012; and;

Sector Treasury Services Ltd - Annual Treasury Management Report (template) April 2012.

5. Appendices

Appendix A – Treasury Management Position Statement for March 2012
Appendix B – Prudential Indicators – outturn for 2011/12 and the PWLB Borrowing Portfolio for HRA Reform

6. Inspection of papers

To inspect the background papers or if you have a query on the report please contact:

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TREASURY MANAGEMENT POSITION STATEMENT AS AT : 31 MAR 2012

[1] CURRENT DEPOSITS

The Council's current deposits are summarised (by counterparty) in the table below:

Counterparty	<i>Principal</i> (£)	*Dividends Received (£)
Bank of Scotland Plc	1,000,000	
Bank of Scotland Plc	3,000,000	
Bank of Scotland Plc	2,000,000	
Lloyds TSB Bank Plc	3,000,000	
National Westminster Bank Plc	4,000,000	
Nationwide BS	1,000,000	
National Westminster Bank Plc	2,000,000	
Heritable Bank Limited	4,000,000	2,766,020
Landsbanki Islands hf	5,000,000	1,518,168
Lloyds TSB Bank Plc	3,000,000	
Nationwide BS	1,000,000	
National Westminster Bank Plc	2,000,000	
Nationwide BS	1,000,000	
Nationwide BS	2,000,000	
Nationwide BS	1,000,000	
Barclays Bank plc	4,000,000	
Barclays Bank plc	1,000,000	
Nationwide BS	1,000,000	
Barclays Bank plc	2,000,000	
Midlothian Council	3,000,000	
National Westminster Bank Plc	2,000,000	
Bank of Scotland Plc	3,000,000	
Nationwide BS	3,000,000	
Barclays Bank plc	3,000,000	
Blaenau Gwent Council	2,000,000	
Peterborough City Council	3,000,000	
Dumfries & Galloway Council	3,000,000	
The Royal Bank of Scotland Plc	3,000,000	
HSBC Bank Plc [<i>Deposit a/c</i>]	1,380,000	
TOTAL DEPOSITED	69,380,000	4,284,188

*The dividends received include both principal and interest, and relate to the impaired deposits held with Icelandic banks and their subsidiaries.

The above deposits include any forward-deals that have been agreed (i.e. deals with a deposit start date that is forward of the agreement date).

The total of dividends now received from the administrators of Heritable Bank Plc represents 67.90 pence in the pound of the total claim. The next dividend has been forecast for April 2012.

[2] CURRENT MARKET EXPERIENCE

a) Treasury Activity

For overnight and very short-term deposits the Council continues to make more use of the HSBC Deposit A/c in preference to the Government DMADF*, as the interest rate is marginally higher on the HSBC Deposit A/c.

b) Interest Rates

A number of short-term and mid-term deposits have been placed in March, at rates in the range 0.32% - 1.75%.

Counterparty	Principal (£'s)	% Rate	Maturity Date	Broker	Deposit Date	Period (Days)
Nationwide BS	2,000,000	1.00000%	01/06/2012	Direct	02/03/2012	91
Nationwide BS	1,000,000	1.00000%	07/06/2012	Direct	07/03/2012	92
National Westminster Bank Plc	2,000,000	0.96000%	15/06/2012	Direct	15/03/2012	92
Bank of Scotland Plc	3,000,000	1.75000%	17/09/2012	Direct	16/03/2012	185
Nationwide BS	3,000,000	0.52000%	19/04/2012	Direct	21/03/2012	29
Barclays Bank Plc	3,000,000	0.45000%	12/04/2012	Direct	21/03/2012	22
Bank of Scotland Plc	3,000,000	0.63000%	23/04/2012	Direct	22/03/2012	32
Barclays Bank Plc	4,000,000	0.73000%	22/05/2012	Direct	22/03/2012	61
National Westminster Bank Plc	2,000,000	0.59000%	24/04/2012	Direct	22/03/2012	33
Dumfries & Galloway Council	3,000,000	0.35000%	03/04/2012	Martins	22/03/2012	12
Lloyds TSB Bank Plc	3,000,000	1.40000%	22/06/2012	Direct	23/03/2012	91
Blaenau Gwent Council	2,000,000	0.32000%	12/04/2012	Martins	23/03/2012	20
Nationwide BS	1,000,000	0.98000%	22/06/2012	Direct	23/03/2012	91
Midlothian Council	3,000,000	0.45000%	03/05/2012	Tradition	26/03/2012	38
Bank of Scotland Plc	1,000,000	1.75000%	26/09/2012	Direct	26/03/2012	184
Lloyds TSB Bank Plc	3,000,000	1.40000%	04/07/2012	Direct	29/03/2012	97
National Westminster Bank Plc	4,000,000	0.96000%	04/07/2012	Direct	29/03/2012	97
Nationwide BS	1,000,000	0.98000%	29/06/2012	Direct	29/03/2012	92
Peterborough City Council	3,000,000	0.50000%	12/04/2012	Direct	30/03/2012	13

[3] DEPOSIT STRATEGY & COUNTERPARTY LIST

The current practice of restricting all deposits with non-nationalised banks and building societies to a maximum of three months is to be continued.

[4] PWLB BORROWING PORTFOLIO FOR HRA REFORM

In order to meet the required payment to the Department for Communities and Local Government (DCLG) in relation to the self-financing of the HRA the following debt portfolio was determined by the Director of Resources under the appropriate delegated authority.

Loan Ref:	Start Date	Principal (£)	Interest	Maturity Date	Term (Years)
1	28-Mar-12	10,678,600	3.46%	28-Mar-38	26
2	28-Mar-12	10,678,600	3.47%	28-Mar-39	27
3	28-Mar-12	10,678,600	3.48%	28-Mar-40	28
4	28-Mar-12	10,678,600	3.49%	28-Mar-41	29
5	28-Mar-12	10,678,600	3.50%	28-Mar-42	30
6	28-Mar-12	10,678,600	3.51%	28-Mar-43	31
7	28-Mar-12	10,678,600	3.52%	28-Mar-44	32
8	28-Mar-12	10,678,600	3.52%	28-Mar-45	33
9	28-Mar-12	10,678,600	3.52%	28-Mar-46	34
10	28-Mar-12	10,678,600	3.52%	28-Mar-47	35
11	28-Mar-12	10,678,600	3.53%	28-Mar-48	36
12	28-Mar-12	10,678,600	3.53%	28-Mar-49	37
13	28-Mar-12	10,678,600	3.53%	28-Mar-50	38
14	28-Mar-12	10,678,600	3.53%	28-Mar-51	39
15	28-Mar-12	10,678,600	3.52%	28-Mar-52	40
16	28-Mar-12	10,678,600	3.52%	28-Mar-53	41
17	28-Mar-12	10,678,600	3.51%	28-Mar-54	42
18	28-Mar-12	10,678,600	3.51%	28-Mar-55	43
19	28-Mar-12	10,678,600	3.51%	28-Mar-56	44
20	28-Mar-12	10,678,600	3.50%	28-Mar-57	45
Total:-		213,572,000	-	-	

This debt was financed entirely by fixed rate maturity loans from the Public Works Loan Board (PWLB). The Council's Authorised Borrowing Limit is currently set at £250,000,000, this debt leaves the Council with £36,428,000 headroom to incur further debt if required.

The borrowing transactions with the PWLB and payment of the HRA Self-Financing settlement to the DCLG were successfully undertaken within the timescales required by the Government.

PRUDENTIAL & TREASURY MANAGEMENT INDICATORS

	Actual 2010/11 £'000	Original 2011/12 £'000	Revised 2011/12 £'000	Actual 2011/12 £'000
<u>PRUDENTIAL INDICATORS</u>				
Capital expenditure				
- General Fund	5,032	7,177	15,260	8,194
- HRA	9,514	10,953	234,241	223,489
Total	14,546	18,130	249,501	231,683
Incremental impact of capital deposit decisions on:				
Band D Council Tax (City element)	0.00	0.00	0.00	0.00
Average weekly housing rent	0.00	0.00	0.00	0.00
Capital Financing Requirement (CFR) as at 31 March				
- General Fund	(894)	(894)	(1,177)	(1,177)
- HRA	893	1,176	215,031	215,031
Total	(1)	282	213,854	213,854
Deposits at 31 March	(56,437)	(57,233)	(63,903)	(63,903)
Net borrowing Requirement	(56,438)	(56,951)	149,951	149,951
Change in the CFR	0	283	213,572	0
Maturity structure of new fixed rate borrowing during 2011/12				
10 years and above (PWLB borrowing for HRA Reform)		Upper Limit 100%	Lower Limit 100%	
Ratio of financing costs to net revenue stream				
-General Fund	(1.93%)	(1.70%)	(1.50%)	(2.46%)
-HRA	(0.12%)	(0.07%)	(0.06%)	0.05%
Total	(2.05%)	(1.77%)	(1.56%)	(2.41%)

Note: 'Original' refers to the Council's Treasury Management Strategy Report (MTS) of October 2011 and 'Revised' to the BSR of February 2012.

APPENDIX B CONTINUED

PRUDENTIAL & TREASURY MANAGEMENT INDICATORS

	Actual 2010/11 £'000	Original 2011/12 £'000	Revised 2011/12 £'000	Actual 2011/12 £'000
<u>TREASURY INDICATORS</u>				
Authorised limit				
for borrowing	10,000	10,000	250,000	250,000
for other long term liabilities	0	0	0	0
Total	10,000	10,000	250,000	250,000
HRA Debt Limit	0.00	0.00	230,839	230,839
Operational boundary				
for borrowing	3,000	3,000	213,854	213,854
for other long term liabilities	0	0	0	0
Total	3,000	3,000	213,854	213,854
Upper limit for total principal sums deposited for over 364 days	5,000	5,000	5,000	5,000
Upper limit for fixed & variable interest rate exposure				
Net interest on fixed rate borrowing/deposits	(320)	(400)	(412)	(448)
Net interest on variable rate borrowing/deposits	(120)	(375)	(23)	(23)
Maturity structure of new fixed rate borrowing during 2011/12		Upper Limit	Lower Limit	
10 years and above (PWLB borrowing for HRA Reform)		100%	100%	

Note: 'Original' refers to the Council's Treasury Management Strategy Report (MTS) of October 2011 and 'Revised' to the BSR of February 2012.